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Business and Economic Conditions

New York, December, 1955

General Business Conditions

THE business boom continues, with trade and industrial activity holding at peak levels and no early slackening in sight. The rate of climb in industrial production has levelled out, as was to be expected after the basic industries began to bump against the ceiling of practical capacity, but this in itself has not dampened optimism. Most people have understood that the spectacular gains of late 1954 and early 1955 could hardly continue; and in housing and automobiles, which have contributed so much to the 1955 showing, a little slippage is more commonly expected than further advances. But in many important lines new orders are outrunning shipments and unfilled orders are still mounting. The urge is for expansion, not curtailment. A good many manufacturers would be producing more if they could; for example, the railway car builders, with order books filled, are unable to operate full time for lack of steel, although the steel producers are turning out all the tonnage that they possibly can.

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The advance in the stock market during November must also be viewed as a sign that confidence, disturbed earlier by President Eisenhower's illness, has risen again. In surveys by one economic pulse-taker after another, business men reaffirm optimistic sales expectations for their own products even though they may see reasons for caution in other parts of the economy. Consumers evaluate their financial outlook cheerfully and consider this a good time to buy.

More and more business reports have been emphasizing the problems of prosperity—scarce materials, labor shortages, transportation bottlenecks, rising prices, and tight money. In an economy with activity at an all-time peak, it is natural to find some lines straining at the seams. Besides the well-publicized shortages of steel, copper, nickel, and aluminum, such varied materials as newsprint, glass, platinum, and cement are in tight supply. Manufacturers find skilled labor increasingly hard to get, while retailers complain of difficulty in finding temporary sales help for the Christmas season. The trend of industrial wages and prices is upward, although obscured in over-all commodity indexes by lower agricultural prices. Few think this trend has yet run its course.

The Boom in Business Investment

Among the specific reports of the month, the most significant place belongs to the results of the annual McGraw-Hill survey of business plans for capital investment, which was conducted in October, after the President's heart attack. According to this survey, expenditures for new plant and equipment in 1956 will be 13 per cent greater than in 1955, or a total of \$33.4 billion. Manufacturers are scheduling a 30 per cent increase, and three quarters of the firms surveyed already plan to maintain or expand this advanced rate of spending during 1957 as well. Producers of iron and steel, automo-

biles, cement, and nonferrous metals plan to step up outlays by more than 50 per cent in 1956.

These ambitious plans speak for themselves. Obviously the companies spending these huge sums anticipate an economic climate in which they can put new facilities profitably to work. They want to expand capacity and modernize plant and equipment in order to be ready for growing markets, keep in step with competition, and hold down costs. New products, new production and distribution techniques, and new plant locations all enter into their plans. The high level of capital expenditures scheduled for 1957 indicates that many of these outlays are part of long-range programs and therefore are less likely to be cut back appreciably in case of short-term business fluctuations.

Experience in past surveys has shown that management is more likely to revise upward preliminary plans for capital spending than to cut them back. In 1956, however, business men may find that they are not able to spend as much as they would like. What they can do will depend in large part upon the ability of the capital goods industries to obtain the necessary materials and skilled manpower. Expansion programs do not break bottlenecks overnight. Meanwhile one shortage tends to breed another. The shortage of freight cars, for instance, has led railroads to place large equipment orders. As already noted, equipment manufacturers would like to step up their output, but have not been able to do so because they cannot obtain the necessary steel. In turn, the steel industry is planning extensive additions to capacity. However, it takes steel to build steel mills, and over the short run the squeeze on certain types of steel will be intensified by the industry's own expansion program.

But whether these expansion goals are fully realized or not, the demand for plant and equipment will be a powerful sustaining force in 1956. It is worth remembering that not only is the aggregate demand for capital goods large in itself, but production of these new facilities also gives rise to employment and purchasing power without making available, over the short run, a commensurate quantity of consumer goods. The rising volume of industrial, commercial, and public utility construction scheduled for next year is counted upon in both Government and private forecasts to more than offset a moderate dip in residential building. Over all, durable goods production may be maintained by producers' equipment purchases, even if automobile production should decline.

Bumping Against the Ceiling

Although some important industries are not pushing against the ceiling as much as those cited earlier, it is clear that further gains in over-all production must be gradual and harder to achieve. Under such circumstances unrestrained increases in demand, made possible by credit expansion, would lead not to a commensurate increase in production and consumption but to a more rapid advance in prices, with the danger of an accelerating wage-price spiral, excessive debt accumulation, and eventual business reaction — in short, the boom-bust cycle. This danger is the justification for the policy of monetary restraint which the Federal Reserve Banks are following. At the same time it argues for continued prudence and caution on the part of business leaders, particularly in inventory policy. Money policy and business prudence have contributed immensely toward keeping the situation steady up to this time. With the strain on productive facilities becoming more rather than less pronounced, the need to keep the foot on the brake increases accordingly.

Here and there are indications of relaxing pressure, reflecting either a lessened availability of credit or saturation of particular markets, or perhaps both. Homebuilding is showing a mild slackening. In October, the number of private dwellings started was at an annual rate, seasonally adjusted, of 1,242,000, compared with an average of 1,373,000 in the first half of 1955. This moderate decline, together with forecasts of a further drop to come, is calling forth criticism of Federal Reserve policy. However, costs of residential building in the past twelve months have risen 4 per cent, which is evidence of tightness in the supply of materials and labor. The question is whether it is better to supply all the credit that every builder may want, cause further inflation of housing costs and prices, and carry on the boom until it is halted by rising vacancies and shrinking demand; or whether, on the other hand, activity should be held within the bounds of productive capacity, price pressures minimized, and the construction spread over a longer period. There can be little doubt as to which course would contribute most to economic stability and best serve the general welfare.

Uncertainties in the outlook relate not only to housing but to automobile demand and the agricultural situation. Looking further ahead, whether one thinks the economy is tilting toward inflation or toward recession depends largely upon expectations as to what the automobile industry can do in 1956. The monetary

authorities, however, cannot safely do too much guessing. They must be guided by the evidence available to them and be prepared to change their course only when new evidence comes in. It may be noted that the action of the Federal Reserve Banks in raising the discount rate is in one sense a business forecast. Obviously they did not fear a downturn in the near future, when they acted to tighten money in the interest of business stability.

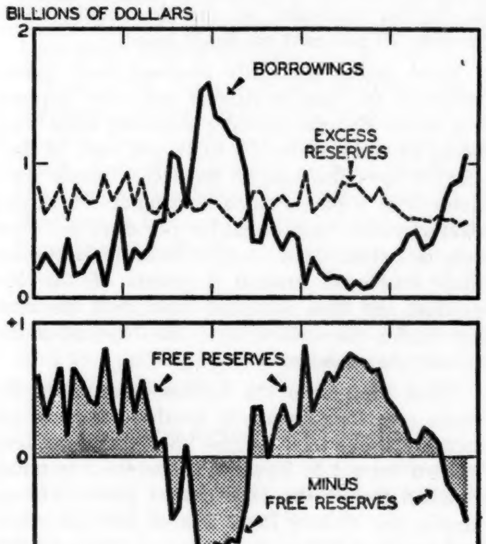
Discount Rate Advanced Further

Effective November 18 the discount rates of the Federal Reserve Banks of New York, Chicago, San Francisco, Cleveland, Philadelphia and Atlanta were advanced another ¼ per cent to 2½ per cent. The other Reserve Banks followed suit within a few days and by November 23 the 2½ per cent rate applied uniformly throughout the country. This makes a one per cent rise since early April and creates the highest discount rate level in twenty years. In the longer perspective, on the other hand, a 2½ per cent rate is a moderate charge for borrowings from the Federal Reserve. Previous to 1930, discount rates as low as this were unknown in the United States.

The action ended several weeks of speculation that the next move undertaken by the authorities might be to ease credit—for the presumed purpose of insuring a background of booming business for the 1956 Presidential election. It will be soon enough for easing action when signs of an economic reversal appear. Meanwhile, current business and credit statistics indicate that the immediate problem remains one of containing a boom that threatens to extend spiralling increases in wages and prices. As a matter of fact, if we did not have a farm problem of falling food prices, we would already have a problem of a rising cost of living. Prices of industrial products and services have been pushing upward as they naturally do when available manpower becomes the limiting factor on production.

The increase in discount rate was intended to restate and reinforce the policy of credit restraint ushered in last summer by the advances in discount rates from 1¾ to 2¼ per cent. One factor Federal Reserve officials took into account was an apparent weakening of the reluctance of banks to borrow at the 2¼ per cent rate. This, combined with recovering bond prices, strong corporate demands for shorter-term U.S. obligations, and expectations of policy reversal, had given the money market an easier feel. Bank loans, after a period of hesitating advance in September and October, tended to accelerate even though increased borrowings from the Federal Reserve were needed to accommodate the loan expansion. During November the main pressure to increase borrowings was felt by the New York banks which, as often happens when money rates rise, experienced deposit losses as national corporations drew on reserve funds to finance purchases, cover increased local payroll accounts, or acquire short-term investments.

On a countrywide basis, member bank borrowings from the Federal Reserve rose from a daily average of $880 million in October to well above $1 billion in November. As the chart indicates, "free reserves" (excess reserves less borrowings) declined from *minus* $350 million in October to around *minus* $500 million in November. The increase in borrowings replenished losses of cash from seasonal currency withdrawals and enabled banks to carry forward their lending activities. The Federal Reserve Banks supplied only a negligible amount of funds through purchases of government securities in the open market.



Member Bank Excess Reserves, Borrowings and Free Reserves (Monthly averages of daily figures, latest months estimated)

Market Effects

The prevailing rate for "Federal funds" rose with the discount rate from 2¼ to 2½ per cent. This is the rate paid by banks on one-day borrowings from one another. The prime commercial loan rate remained undisturbed at 3¼ per cent, but banks marked up the rate on brokers' loans from 3½ to 3¾ per cent. Among open

market rates prime 90-day bankers acceptances were marked up ⅛ to offer the buyer 2¼ per cent. Prime 4-6 months commercial paper was advanced ⅛ to 2⅞ per cent and major finance companies added ⅛ to their rate schedule which now offers from 2½ per cent for paper under 90-days up to 2⅞ per cent for nine months.

Yields on 91-day Treasury bills edged past the 2.42 percent peak of the 1953 money pinch, reaching 2.45 per cent on the new issue dated December 1. Bill yields before the new discount rate change had been swinging in a range of from 1.90 to 2.33 per cent in response to fluctuating demands and changing expectations with respect to credit policy. The Treasury fitted its December refunding to the new structure of rates. A choice between 2⅝ per cent 1 year certificates and 2⅞ per cent 2½ year notes was offered to holders of $12.2 billion certificates and notes maturing December 15.

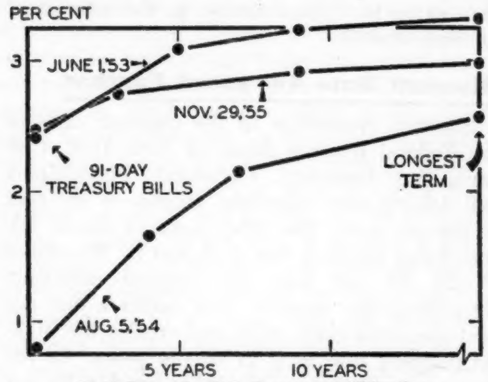
The strength of stock and bond prices in October was an influence in favor of discount rate advance. As respects the stock market, the discount rate action represented an alternative to further increase in margin requirements, already 70 per cent on listed issues.

Bond prices generally reached their lowest points of the year in August and early September when Federal Reserve discount rates were being moved up from 1¾ to 2¼ per cent. At their August lows the longest term U.S. bonds were down 5 or 6 points since December '54, raising offered yields from about 2⅝ per cent to 2⅞ per cent or better. From August to early November they recovered around 2 points of the lost ground, and then retreated 1 point on the average under the influence of the November discount rate advance.

Thus, even after the further advance in discount rate, long-term U.S. bonds remained comfortably above their August lows, and those lows in turn were 4 to 5 points above the low points touched during the 1953 money pinch. For example, the Victory Loan 2½s of 1967-72, which had touched 89⅞ in the spring of 1953 and 93⅞ in August of this year, closed November at 94¾. The forty-year Treasury 3s issued initially last February, which had traded down to 98¼ in August, closed November at 100.

Flattening Yield Pattern

The remarkable stability of bonds in general, and of the forty-year Treasury 3s in particular, appears to be explained in the main by the growth of the resources of pension trust funds which naturally desire to hold some considerable proportions of their assets in bonds. The Treasury 3s are considered particularly desirable because they assure a 3 per cent return for forty years and involve neither risk of default nor risk of call before maturity. These bonds have found a wide distribution in strong hands and bids of par or better have been required to attract any considerable offerings — even under "tight" money market conditions.



Yield Curves for U.S. Government Obligations

The rise in Treasury bill yields, against the 3 per cent yield on the forty-year 3s at par, has produced the flattest yield curve experienced since 1933. As the chart indicates, the spread between 91-day Treasury bills and long-term Treasury bonds toward the close of November was not much more than ½ per cent. Early in June 1953 Treasury bill yields rose practically as high as now, but the longest-term Treasury bonds yielded 3.30 per cent or better and the margin over bills still amounted to ⅞ per cent. Under the easy money policy of 1954 the collapse of bill yields widened the spread to 1¾ per cent or more.

Everyone — from the Federal Reserve and Treasury authorities down to the smallest financial institution — is having to learn how fluctuating credit conditions bear upon various classes of money rates. It is natural that the shorter term rates should fluctuate more widely. Indeed, previous to the easy money era introduced by the dollar devaluation in 1934, short-term rates sometimes rose above those at long-term. Possibly this will happen again. As a matter of fact, a few corporate borrowers recently have been able to float bond issues at money costs below the 3½ per cent prime commercial loan rate. The bank loan, nevertheless, remains cheaper if borrowing needs are of a temporary character — or if long-term borrowing costs can be expected to fall. These are reasons why people sometimes will pay premium rates for the flexibility of short-term bank credit lines.

New Flexibility of Discount Rate

The Federal Reserve discount rate has been changed four times in 1955, and the financial community is on notice to watch for more changes, either way, as business and credit conditions warrant. It has been the clear intention of the authorities to convert the rate from a symbol of policy to a ready weapon.

Mr. Allan Sproul, President of the Federal Reserve Bank of New York, gave fair warning in a speech delivered before the Pacific Northwest Conference on Banking last April 7. He set out "some of the things which might conceivably come about . . . if economic recovery continues along a healthy course":

> First, "Some revival of discount operations at the Federal Reserve Banks";
>
> Second, "Some rise in interest rates" but not too fast to be damaging;
>
> "Third, changes in the discount rates of the Federal Reserve Banks might be made more frequently in such a period, as the discount window of the Banks again became busy, and as interest rates become more sensitive indicators of market pressures. In such circumstances, the discount rate could assume the role of an anchor for the whole structure of interest rates. And eventually it might lose some of its ponderous significance as a symbol, while it gained in power as a ready weapon of monetary policy."

The surge of business has outrun almost any forecast offered last April. Advances in discount rate have been more numerous than anyone then expected would be desirable and necessary. But the pattern of policy suggested by Mr. Sproul has been pursued. The discount rate has been restored to the position it traditionally held, as an "anchor for the whole structure of interest rates."

Federal Reserve Board Chairman William Martin testified November 28 before a subcommittee of the Senate Banking and Currency Committee concerned with the effects of the policy of credit restraint on homebuilding. It is the Government's collective endeavor, he said, "to prevent another 1929 if it is possible to do so":

> Under prevailing conditions demands for funds are running far ahead of the supply of savings. To meet these demands by creating new supplies of money through the commercial banking system with Federal Reserve assistance would invite dangerous inflationary repercussions throughout the entire country.

As Treasury Under Secretary W. Randolph Burgess described the housing situation:

> In times like these, with business activity straining at capacity, we cannot run the inflationary risks of manufacturing money through bank credit to encourage a level of housing starts that probably could not be sustained because of shortages of labor and materials. This would only result in further price increases.

The Farm Problem

The renewed weakness of farm prices points up anew the old problem of what to do about agriculture.

Despite price support programs which have piled up huge stores of farm commodities in government hands or under government loan, the goal of agricultural price stability remains an elusive will-o'-the-wisp. In the effort to cope with these unwieldy surpluses, the Government has tried both (1) acreage restrictions and marketing controls, and (2) giving away, bartering, or selling the surpluses, at home or abroad, wherever it can be done without clogging the regular channels of trade.

Neither of these courses has succeeded. Farmers have offset production curbs by cultivating their acreages more intensively or by shifting to unrestricted crops, thereby transferring the surplus problem to new areas. At the same time, surplus disposal has found the going difficult. While the program has had some measure of success, in general getting rid of the surpluses without displacing the regular trade has been easier said than done.

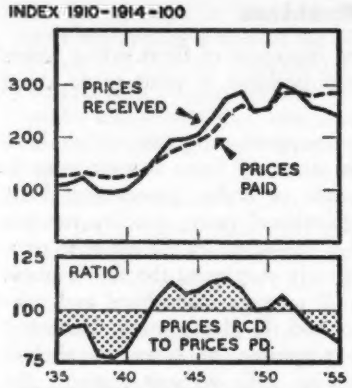
Thus, while price supports don't support, the surpluses continue to build up. The Government has the bear by the tail and dares not let go. Some observers, including several members of the Congressional farm bloc, have forecast that the drop in farm prices and income, if not soon halted, will pull the entire nation into a depression. Barring a turn in the trend of farm prices, the "farm problem" bids fair to becoming the No. 1 issue of the Presidential campaign. And thoughtful people everywhere, both in and outside of agriculture, are groping for a solution.

Farm Prices and Income

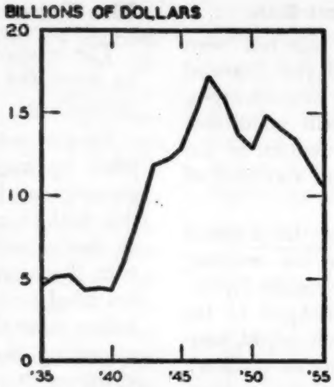
In seeking such solution, the first requirement would seem to be to see precisely what is happening to farm prices and income.

The charts at the top of the next page trace in outline three standard measures of farm price relationships and income over a twenty-year period back to 1935. The long-term figures make comparisons possible not only with the boom years in agriculture during and after the war – the best years agriculture ever had – but also with the depressed '30s.

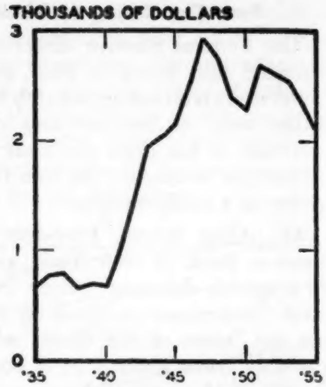
The chart at the left compares prices received by farmers for what they sell with prices paid for what they buy – the so-called "farm parity ratio".



Prices Received and Paid by Farmers and the Parity Ratio



Realized Net Income of Farm Operators

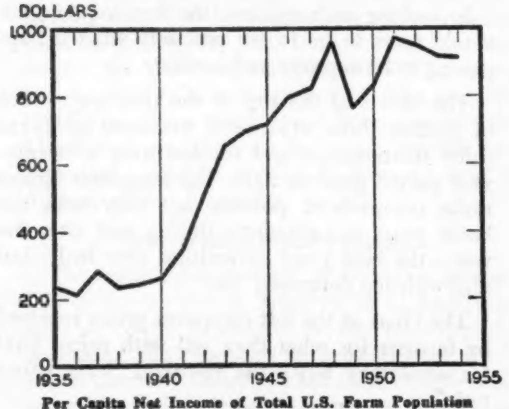


Operators' Realized Net Income Per Farm

It will be seen that the prices received have gone off sharply, the average for the first 10 months of this year being down 20 per cent from the postwar peak reached in 1951. While this leaves prices received still far above prewar, the decline that has occurred, coupled with the rise and subsequent stickiness of prices paid, has wiped out the favorable "price spread" the farmer enjoyed during the lush war and postwar years and substituted a "price squeeze" instead. This is reflected in a decline in the "parity ratio" from an average of 115 in 1947 to 85 in the first 10 months of '55, and to 82 in the month of October alone.

Aggregate realized net income of farm operators from farming, shown in the center chart, is also definitely down. Based on data now available the total for the year is estimated at $10.6 billion, against the postwar peak of $17.2 billion in 1947, a decline of 38 per cent.

Because of a decline in the number of farms, the net income per farm – shown in the right-hand chart – reflects somewhat less erosion, the estimated figure for '55 being down 28 per cent from '47.



Per Capita Net Income of Total U.S. Farm Population (Latest figure 1954)

Total net income of the farm population as a whole, including farm wages and income from off-the-farm jobs and investments, has – as shown in the accompanying chart – held up much better than farm earnings of farm proprietors alone. The average per capita in '54 was down only 7 per cent from the '51 peak, with a further decline indicated this year.

The figures cited earlier are nevertheless clearly indicative of a major readjustment taking place in agriculture which is causing hardship to many individual farmers. The fact that farm income has declined at a time when the country as a whole is enjoying record prosperity does not make the readjustment any more palatable in the farm regions.

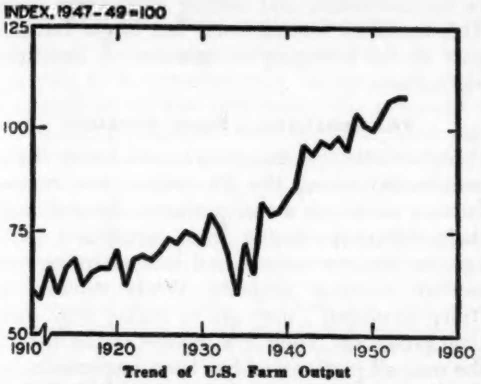
Growth of Farm Productivity

The trouble is, of course, that American agriculture for some time has been producing far in excess of market requirements. While this will hardly be news, it is doubtful if there is general awareness of the spectacular growth of farm output that occurred during and after World War II.

The chart on the next page depicts this growth. In a period of some fifteen years since the late '30s U.S. farm output increased around 40 per cent – approximately as much as in the previous three decades.

With the nation's cultivated acreage today little changed since 1920, this achievement reflects a veritable miracle in increased farm efficiency.

While farm productivity had been increasing gradually for a long time, it was not until the late '30s that the results of the new technology began to be sensationally apparent. During the



Trend of U.S. Farm Output

early '30s progress was discouraged by drought, depression, and plentiful supplies of cheap farm labor. Then came the war with its pressure to produce, combined with labor shortages, high prices, and high wages — all making the time ripe for the introduction of the new equipment, fertilizers, and methods which had been developed over the years by the Department of Agriculture, the state agricultural colleges, and the research laboratories of the farm equipment companies and other private industries.

Mechanization, electricity, improved livestock breeding and feeding, and higher-yielding varieties of crops wrought wonders in boosting yields per acre and per animal, and in conserving manpower.

In 1940, 23 per cent of our people lived on farms. Today, only about 22 million of our total population of 165 million, or less than 14 per cent, live on farms. Some 20 per cent of our labor force in 1940 was employed on farms, and one farm worker produced enough farm products for himself and nearly 10 additional consumers. Today, only about 13 per cent of our civilian labor force is employed on farms, and one farm worker produces enough food, fiber, and tobacco for himself and nearly 18 other persons.

Total man-hours devoted to farm work has declined about 28 per cent since pre-World War II, while output per man-hour is nearly double pre-World War II and around 30 per cent above 1947-49.

These huge strides in farm efficiency have caused our farm output (despite recent restrictions on several leading crops) to soar well above our needs. While consumption of farm products is increasing steadily with growth of our population and improving living standards, and today is higher than ever before, there are — after all — limits to the amount that people can eat.

Exports, which during the war and early postwar years absorbed a large share of our mounting farm output, have fallen off with the recovery of agricultural production abroad. Foreign countries can no longer be counted on to take our farm surpluses at the former rates; many of them have surplus problems of their own.

Too Many Farmers

The moral seems inescapable: Despite the long-term downward trend of the farm population, quickened since the late '30s both by growing mechanization on the farms and increased opportunities for nonfarm jobs, there are still too many farms and farmers.

Superficially, what has been happening in agriculture may look like a case of an outstanding job bringing a poor reward. Actually, this misinterprets what has been taking place. Farming has been developing intensively the same competitive pressures that come in every line of business as some units forge ahead with new products and new methods that other concerns for one reason or another are unable to match.

But whereas in industry an almost continuous adjustment takes place whereby the less enterprising and less efficient concerns are sifted out and disappear as their proprietors shift to jobs for which they are better fitted, in agriculture this process of adjustment has been retarded by policies that have held a protective umbrella over the efficient and the inefficient alike. Not only have the high rigid price supports of recent years tended to keep too many people in agriculture but, by freezing production patterns, to keep them producing the wrong things. As one commentator (*) aptly puts it:

> Rising productivity has meant and still means overproduction and declining prices. And thus the U.S. Government, which long ago underwrote the rise of farm productivity by underwriting the cost of farm technology and research [not to speak of billions of dollars spent for reclamation and irrigation — ed.], turned around and used price supports to protect farmers not only against the market distortions caused by war and depression, but also against the economic consequences of rising productivity.
>
> The Government, in other words, subsidized efficiency and then subsidized inefficiency, and it is this Janus-like policy that today is chiefly responsible for what the economists describe as "an excess supply of resources in farming."

Farming As a Business

Despite the tremendous improvement in overall productivity, many farms are far from efficient. According to the 1950 Census of Agriculture about 2.1 million units large enough to be classified as bona fide commercial farms (grossing $2,500 or more annually) produce about 88 per cent of our marketable farm products.

* *The Magnificent Decline of U.S. Farming* by Gilbert Burck, Fortune, June, 1955.

The other 3.3 million farms, over 60 per cent of the total, produce only 12 per cent.

Of the non-commercial farms, about half are classified as either part-time, residential, or miscellaneous (institutional, experimental, etc.). The other half are mainly subsistence farms, grossing in many cases less than $1,000 a year and too small to provide anything but a bare living for their occupants regardless of the times.

Whereas the farmer is often thought of as a "little man", actually the typical commercial farmer is a man of substantial capital. Department of Agriculture studies show that the average investment in commercial family-operated farms in 1954 ranged from $11,340 for a 45-acre Mississippi delta cotton farm to $137,160 for a 512-acre winter wheat and pea farm in Washington and Idaho. On many corn belt farms the investment per worker exceeds $50,000. This is three to four times the average investment required to create one job in industry. What was once a "way of life" has become a "way of making a living". Farming today is a business, subject not only to natural hazards but also to the economic hazards faced by urban industry and trade.

Looked at from a balance sheet standpoint, this "business" in the aggregate makes an impressive showing. According to official figures, U.S. farmers on January 1, '55 held real estate valued at $91 billion, equipment, crops, livestock, etc., $50 billion, and cash and investments of $22 billion – a grand total of $163 billion. Against this, farm indebtedness stood at the relatively low total of $18 billion, leaving a net equity of $145 billion – up $1.3 billion for the year. Indebtedness amounted to only 11 per cent of total assets, against 19 per cent in 1940 and 21 per cent in 1930. Farmers as a whole held at the beginning of this year enough liquid financial assets to more than retire their debts.

While some young farmers, particularly those who started farming with only a small equity and at the peak of prices, are in debt trouble, this condition obviously is not representative of commercial farmers generally. About seven out of ten farms have no mortgage debt.

Farm real estate values, despite the decline in farm prices and income, have been strengthening. For the country as a whole, the average per acre value on July 1 last was 5 per cent above a year earlier and equal to the 1952 all-time peak. While the favorable crop yields this year and the buoyancy of the general economy have stimulated demand, an important element has been a desire to enlarge the size of existing farms with a view to taking further advantage of mechanization and cutting production costs. This tendency toward fewer but larger farms is part of the changing complexion of American agriculture.

The Subsistence Farm Problem

Notwithstanding the general well-being of our commercial farms, the 1½ million low income farmers constitute a real problem. By and large their difficulties spring from insufficient acreage, inadequate capital, and lack of training in modern farming methods. While counted as "fully employed", they are in reality only part-time producers. Their low income status distorts the over-all picture and has been responsible for much of the agitation for high price supports and other farm aid programs. Yet these groups benefit least from high price supports because of their limited production, whereas the large producers already profiting from low production costs benefit most.

Thus, solution of the low income farm problem would seem to boil down inevitably to the alternative of raising productivity wherever it can be done, or else getting the inefficient producers into other occupations. The latter may seem like a harsh remedy, and politicians more interested in getting votes than in finding true solutions use such phrases as "plowing the farmer under".

Actually, farming today requires a high level of technical and managerial competence, including knowledge of soils and crops, animal husbandry, and repair and maintenance of machinery. Not everyone is suited to it. How much better for all concerned, if those not suited find their places in other lines of endeavor. After all, landing a job in the city at the highest level of wages in history is not exactly being "plowed under". Such shifts are part of a long-range pattern whereby workers released by increasing productivity in agriculture have augmented manpower to make possible this country's great growth in industry and trade generally.

None of this implies that the family farm, which has been characteristic of American agriculture, has to go. As Charles B. Shuman, President of the American Farm Bureau Federation, pointed out in an address before the annual meeting of the American Bankers Association last September:

> To be efficient today a farmer has to have a business large enough to justify the capital investment required by modern farming methods. This does not mean we are moving away from the family farm. It simply means that the family farm is growing with the economy of the country.

The Role of Government

That government can assist farmers in adjusting to the revolutionary changes taking place in agriculture few will deny. But programs for helping agriculture, to be successful, must facilitate rather than obstruct adaptation to changes that are inevitable. Again quoting Mr. Shuman in the address just cited:

> The future of agriculture is still bright if we reduce the role of government in agriculture and produce for the rapidly expanding consumer market rather than for government storage bins. We have lost much of our market both at home and abroad as a result of unwise fixing of prices at 90 per cent of parity. The total agricultural plant is overexpanded. Any government program which encourages further expansion is not in the long-time best interests of farmers. High, rigid price supports, subsidy or income payments, and special government purchase programs all delay needed adjustments and in the long run will further reduce farm income.

A striking illustration of the truth of this statement and of the bankruptcy of the high rigid price support policy is afforded in the recent report of the International Cotton Advisory Committee, an intergovernmental organization to promote cooperation in the solution of world cotton problems:

> If present trends continue, in two more seasons cotton production outside the United States may be sufficient to meet all consumption requirements outside the United States without any imports from that country.

Thus the outcome — for years warned against by economists — of pegging American cotton prices above world markets and stimulating foreign production to the point of making the rest of the world independent of American cotton, now looms close at hand. What is happening to our cotton markets is but one example of the problems in agriculture created by government policies that encourage continued over-production and obstruct natural economic adjustments.

World Trade and Capital Flows

While the need to restrain inflation has injected a note of caution into international councils, the Free World as a whole continues to enjoy the highest level of prosperity in history. Even in 1954, when the United States and Canada were experiencing a brief recession, many indicators of world activity moved upward to new high levels. This year, with the boom on this continent joined to the continuing expansion in Europe, new records in production and trade have been virtually worldwide.

Compared with the decade of the depressed 'thirties, few areas can show gains as great as those in the United States, where industrial production is now well over double the 1937 rate. Taking only the last few years, however, the most striking advance has been in Western Europe, where production has risen by more than 75 per cent since 1948.

In several other areas, too, the economic picture is encouraging. Significant progress has been made by Japan and India in the face of population problems and other difficulties. An improvement in food supplies over the last few seasons has benefited the whole Far East. Strong world demand for raw materials has speeded development in Africa. Expansion has continued in some Latin American countries, though marred in many cases by inflation, exchange difficulties, and lags in agriculture.

With many trade barriers relaxed, world trade has risen to new high levels. In the first half of 1955, according to the estimates of the International Monetary Fund, world exports reached an annual rate of nearly $81 billion, against $76 billion in the same period of 1954. The physical volume of international trade is estimated roughly one-third above the prewar 1929 record.

Here also the greatest recent expansion has been shown by Western Europe, partly because of expanded intra-European trade. German exports, continuing their remarkable record, so far this year are running 17 per cent above the 1954 level. Gains have run to almost 15 per cent for France and to roughly 10 per cent for Italy and the Netherlands. As for Britain, the difficulty there is not one of an export slump but of excessive imports. After declining in the second quarter because of the dock strike, British exports have recently been running at record levels.

Expansion in U.S. Exports

The United States has shared in the expansion of trade. In 1955 our exports, excluding military aid, are expected to approximate $14 billion, against $12.7 billion in 1954 and $12.3 billion in 1953. This would be the highest level on record except for 1947, when foreign countries drew heavily on their reserves to satisfy exceptional postwar demands. While our exports of farm products have fallen as a result of the rise of production abroad, nonagricultural exports are at an all-time peak, with foreign sales of motor vehicles and parts, chemicals, wood and paper products, and nonferrous metals particularly strong this year.

The bulk of the increase in our exports reflects demand created by the European boom. Over the past two years, Western Europe has moved ahead of Canada and Latin America to become our biggest single export market. As these coun-

tries have run against the limits of their own capacity, they have bought more American coal, steel, and other materials to sustain current production, as well as more capital equipment to sustain the investment boom which is expanding and modernizing European industry.

The willingness of European and other foreign countries to spend dollars more freely reflects better dollar earnings and – with the leading exception of England – the restoration of currency reserves to safer levels. Foreign holdings of gold and short-term dollar assets outside the "iron curtain" have risen from $18 billion in September 1949, when European currencies were revalued to a more realistic basis, to $29.4 billion as of June 1955, with Western Europe accounting for two-thirds of the increase.

A reduced accumulation of dollars by foreign countries from transactions with the U.S. has been offset in part by a greater flow of newly-mined gold into official reserves. As the threats of inflation and war have receded, hoarding has become less and less attractive compared with productive investment, and premiums on bar gold have dwindled. Even in France, where postwar hoarding has perhaps been greatest, some gold was attracted to official reserves in the spring of this year.

Movement Toward Liberalization

The buildup of the reserves, following the currency revaluations of 1949, is an essential aspect of the broadened base of international prosperity. Competitive pricing of exports strengthened foreign exchange earnings, giving – along with American aid – buying power for capital goods. Recovered domestic production, aided by tax relief, restored self-sustenance, bolstered export earnings, and gave people a wider range of choice of imported goods, a higher respect for their national currencies, and added incentive to work. Moreover, as fears of an American depression have lessened, confidence has increased that dollar markets will remain open and that the outflow of dollars from the U.S. will hold at a high level. All these developments have contributed to the great movement away from trade and payments restrictions over the last few years, and to the resulting expansion of world and U.S. trade.

Although the goal of full currency convertibility remains to be achieved, the movement toward freer flow of goods, services, and capital continues. Last spring, West Germany raised the proportion of its dollar imports freed from quota restrictions from 57 to 75 per cent. Belgium has removed almost all restrictions from capital exports. France recently indicated that she is ready to make a start in the removal of barriers.

Trade and exchange liberalization is more and more recognized as a competitive necessity. Countries such as Germany and the Netherlands, which have removed most controls, are able to buy supplies wherever they are cheapest (often the dollar area) and thus gain a cost advantage over their competitors. France, which has kept its barriers high, is now discussing steps to stimulate domestic efficiency by allowing more competition from the outside. In short, experience has illustrated the classical principle that a high level of trade adds to the real income of the participating countries.

A prerequisite for the liberalization movement has been the great progress made by the leading countries of the world toward reestablishing sound currency systems. Significantly, the countries which have shared fully in the expansion of trade – notably the United States, Canada, Western Europe, and Japan – are those which have applied monetary and fiscal policies flexibly and effectively to stop inflation and stabilize the value of their currencies.

Although all these countries are industrialized, their mutual trade has increased more rapidly than their trade with raw material producing countries. The most striking expansion of all has been in intra-European trade, now largely freed from quota restrictions within the framework of the Organization for European Economic Cooperation. Trade among the 17 O.E.E.C. countries rose by 128 per cent between 1948 and 1954, against a gain of 83 per cent in the area's exports to the outside; this mutual trade is now estimated at 70 per cent above prewar in physical volume.

Transactions with the United States

Despite increased economic strength abroad, transactions with the United States will continue to have a crucial bearing on the currency reserves and general trade and financial position of foreign countries. Even in 1954, during the recession, the amount of dollars made available by our imports, government spending, and other activities came to $19½ billion, within a shade of previous peaks. This year, as shown in the table, with U.S. business activity at a new high, total dollar supplies are expected to exceed $20 billion for the first time.

Merchandise imports are the biggest source of foreign dollar earnings. Although increases in tariffs on watches and bicycles have stirred apprehensions of a protectionist turn in U.S.

U.S. International Transactions

(Billions of Dollars)

	1950-53 (annual av.)	1954	1955 (estimated)
Transactions Supplying Dollars:			
Commercial imports*	10.5	10.3	11.3
Services	2.8	3.1	3.3
U. S. Govt. outlays	4.8	4.5	5.4
Private capital outflow	1.0	1.6	.6
TOTAL DOLLARS SUPPLIED	19.1	19.5	20.6
Transactions Using Dollars:			
Commercial exports*	12.5	12.7	14.0
Div. and int. remit. to U. S.	1.8	2.2	2.4
Other services and transactions	2.9	2.8	3.1
TOTAL DOLLARS USED	17.2	17.7	19.5
Added to foreign gold and short-term dollar assets	1.6	1.6	.5
Added to foreign holdings of portfolio and direct investments	.3	.2	.6
TOTAL	1.9	1.8	1.1

* Adjusted for balance of payments purposes.

trade policy, U.S. imports are expected to run well over $11 billion this year, against the previous record of $10.9 billion in 1951.

Dollars are also being supplied overseas by government economic grants and credits, particularly in Asia. Total U.S. Government outlays abroad – including spending for goods and services and economic aid, but excluding gifts of military equipment – may total $5.4 billion this year, against $4.5 billion in 1954. Private spending abroad for travel, foreign shipping, and other services is also heavier. Private capital outflow, abnormally swollen last year by a movement of short-term capital to centers where interest rates were higher, is in reduced volume.

It is noteworthy that foreign nations have felt their gold, dollar deposits, and short-term dollar assets sufficiently strengthened to permit larger long-term investments in the United States.

Economic Development

A better outlook for world peace, progress toward eliminating exchange controls, and some easements of tax obstacles have widened public interest, at home and abroad, in foreign investments. Europeans are freer than in years to invest in American common stocks. And more Americans are giving consideration to investments in Europe as well as Canada. American corporations continue to make direct investments, particularly in the development of mineral resources, wherever they feel the potential returns may be adequate to the risks. Nevertheless, hopes of encouraging heavier outflows of American private capital, as an addition to the supply of dollars, a substitute for government aid, and a force for economic development, remain to be fulfilled. The difficulties stem from many fronts. Investments at home may seem better; they are at least more familiar. The overseas investment faces risks of nationalization, onerous taxation, and currency inconvertibility.

The outflow of private long-term capital in recent years has averaged $400-$450 million to Canada and $500-$600 million to other areas. This year the totals are somewhat lower. In view of the obstacles mentioned above, the massive outflow of funds sometimes envisioned as a cure-all for the dollar problem does not appear likely to take place in the foreseeable future. On the other hand, the adjustment of public policies to invite and encourage private capital can over time achieve large results. The development of this continent with the aid of European capital provides the classic example.

Economic development is a universal aspiration. To get on with the job many governments are venturing into business themselves. Yet this sort of haste makes waste and may even defeat the purpose. On this point Eugene R. Black, President of the World Bank, offered wise counsel in his opening address before the recent meeting of the Bank and International Monetary Fund at Istanbul:

> Perhaps the greatest disadvantage from state ventures into industry is that they will divert resources and attention from fundamental tasks which, in the underdeveloped countries, for the most part, are either going to be carried out by the government or are not going to be carried out at all. Government investment in industry means correspondingly less investment in the basic services . . . [that] are fundamental not only to industrial development but to all development.

After referring to the natural desire of governments to speed up the development process, Mr. Black observed:

> Yet if the real benefits of industrialization are to be obtained, I think that governments should undertake such ventures, if at all, only as a last alternative and only after a full examination of other alternatives that exist. And even in cases where a government may go so far as to start an industrial enterprise, I think every effort should be made to put the venture into the hands of private capital and private management as quickly as possible.
>
> For rare exceptions do not disprove the often illustrated rule that it is not in the nature of government to act with the flexibility or the attention to business considerations that is required of good industrial management. And – successful or not – so long as the enterprise stays in government hands, it does not stimulate the growth of similar enterprises, because private investors who could finance them are not willing to try to compete with government. The net result of these state ventures, more often than not, is to restrict the growth of production – or in other words, to defeat the very purpose they seek.

This is good advice, which can be taken to heart in all countries – our own as much as any other.

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